

# การจัดตั้งและการบริหารงานบริษัทร่วมค้า (Joint Ventures) ของธุรกิจก่อสร้างในประเทศไทย

## FORMATION AND MANAGEMENT OF CONSTRUCTION JOINT VENTURES IN THAILAND

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### บทคัดย่อ

การศึกษานี้ได้รวบรวมและประเมินผลประสบการณ์จากเจ็ดบริษัทร่วมค้า (Joint Venture Companies) เพื่อหารูปแบบและวิถีทางที่จะนำไปสู่ความสำเร็จในการร่วมค้า และการดำเนินงานธุรกิจก่อสร้าง ในประเทศไทย โดยคำนึงถึงเหตุผล ในการจัดตั้งบริษัทร่วมค้าในธุรกิจก่อสร้างจากมุมมองของทั้ง บริษัทต่างชาติและบริษัทไทย การศึกษานี้ครอบคลุมถึงขั้นตอนการจัดตั้งบริษัทร่วมค้าในประเทศไทย, หนทางและปัจจัยในการเลือกบริษัทคู่ค้า (Partner) และการพัฒนารูปแบบต่าง ๆ ในการร่วมค้า เพื่อให้เหมาะสมกับสภาพท้องถิ่น ผลการศึกษา สรุปความได้ว่าปัจจัยสำคัญที่ยังผลให้การร่วมค้าประสบ ความสำเร็จหรือล้มเหลวนั้น คือ ความพิถีพิถันในการเลือกบริษัทคู่ค้า (Partner Selection.)

### ABSTRACT

The study draws on the experiences of seven joint venture companies to formulate guidelines for successful construction joint venture formation and operation in Thailand. Reasons for establishing a construction joint venture are considered, both from a foreign company point of view and that of a local Thai company. Procedures for establishing a joint venture in Thailand, the avenues for and factors controlling partner selection and the development of different types of venture companies to suit local conditions are also covered. It is concluded that partner selection is a major factor determining the success or failure of joint ventures.

## INTRODUCTION

In the construction industry, a joint venture (JV) is one of a variety of means a construction firm can exploit to establish in a foreign market. However, joint venturing is not limited to instances in which a company is entering into foreign markets and may be used by firms operating in the same market for different reasons listed later in this paper. Before entering into a construction joint venture (CJV) in a foreign country, a contractor should examine first the relative advantages of the other vehicles of entry into foreign markets. This study aims at establishing preconditions to successful JV formation between foreign and local contracting firms in Thailand.

The term "construction joint venture" is heard increasingly in the construction industries the world over; Thailand not being an exception. Often it is used as a means for winning contracts or for reducing risks. A CJV is a distinct form of business association created by its owners to combine certain attributes of one venturer with complimentary features of another for the purpose of engaging in a specific construction undertaking either on a one-term project or on a long-term basis. The enterprise is co-owned and co-managed by the JV partners. For foreign investors, it is seen as a means for penetrating the local market or to gain access to cheap local resources. Certainly there are occasions when it provides a tender proposal with an extra edge. However, if a CJV has been entered into without full consideration of all the issues involved, then its weaknesses will likely be exposed precontract by the client, resulting in no award, or worst, at the execution phase with consequent problems for all concerned. This paper therefore addresses the major considerations necessary for the formation of successful JVs in Thailand.

## RESEARCH PROCEDURE

Data for the study being reported were gathered through mailings, faxes, telephone calls, questionnaires and personal interviews. A prospective respondent, a construction

company (and a JV in particular) was sent a letter (through fax or mail) indicating the desire to conduct a research on JV formation and management in Thailand. Responsive companies were then interviewed using a structured/unstructured questionnaire. Thirty eight companies were contacted for the study, out of which, only 27 were identified as joint ventures or joint venture partners. Of the 27, only seven companies agreed to provide data needed for the study. The work reported in this paper is the result of the study.

## TYPES OF CONSTRUCTION JOINT VENTURES

CJVs exist structurally in two forms, integrated and non-integrated. An integrated JV acts as a single company in undertaking projects. Partners contribute working capital to the CJV's bank account, hire all office and job personnel on the JV's payroll, buy supplies and rent or purchase all equipment in the name of the CJV<sup>1</sup>.

In a non-integrated JV, each venturer is responsible to the JV for a specific number of job items as set forth in the JV agreement, while being jointly and severally bound to the project owner for the whole conduct of the project. The local party acts as the managing partner (or sponsor) and his address is used for the JV. Each partner hires all personnel and purchases or hires all equipment necessary for own work items. The partners also use own checks and accounts for paying suppliers<sup>1,2</sup>. In relation to the law, CJVs can also exist in two forms; namely: incorporated and unincorporated. Incorporated JV is a continuous entity whose formation is governed by the laws of Thailand. Unincorporated CJVs are project oriented and their establishment is not governed by any government formalities<sup>3</sup>, but rather by what is known in law as gentlemen's agreement.

From the foregoing, it is seen that JVs in Thailand can exist in three (3) forms, viz:

1. Integrated/Unincorporated
2. Integrated/Incorporated
3. Non-integrated/Unincorporated

**Integrated/Unincorporated CJV** Under this form, contractors contribute working capital and expertise for the creation of one single entity to undertake a single project<sup>1</sup>. A separate legal entity is not formed in this process<sup>3</sup>. As such, the JV cannot be sued but individual venturers can be held liable for the actions of the JV. The entity is dissolved on the completion of the project. This form of CJV is suitable for large projects where one company finds it hard to prequalify for tendering and where job items are difficult to classify or separate to permit a consortium type of CJV.

**Integrated/Incorporated CJV** Under this form, business entities (not only contractors) contribute capital and expertise for the creation of a single company to act as a specialist contractor<sup>1</sup>. A separate legal entity is formed in this process, hence, the creation of the company is governed by every formalities set forth in the laws of Thailand. Since the resulting company is incorporated, it is not dissolved on the completion of the project<sup>3</sup>. As long as there are projects, as long as productive environment exists or as long as the desire to cooperate exists, the entity also exists, subject to the discretion of the partners. This form of CJV is suitable for projects of any size, depending on the capital set up by the venturers.

**Non-integrated/Unincorporated CJV** Non-integrated/Unincorporated CJV is commonly called a “consortium”. When there is a large project and the job items can easily be divided into job items to suit the individual expertise of the prospective venturers, then this form of JV is very suitable. However, like the integrated/unincorporated CJV, a separate legal entity is not formed in this process. This form of CJV is project oriented and the association is formed for a specific project, hence, it is dissolved upon the completion of the said project.

### **Organization OF JVs**

Since the organization of any CJV involves several contractors or firms, the organization

head (could be a Management Team or a Board of Directors) has the delicate task to maintain proper balance of all the participants and to satisfy all participants' and sometimes the government's interests. The key to a successful CJV management is establishing a relationship of mutual trust, respect and confidence between the project management and the participants. The establishment of a management team depends on the form of CJV being formed.

**Integrated/Unincorporated CJVs** The management organization of this form of CJV is similar to the integrated/incorporated form in many respects. It is managed by a Board of Directors, elected by the venturers even though it is not a separate company. Once in place, the Board independently manages the JV, subject to the limitations set forth by the JV agreement. The chairmanship of the board is given to the partner with the highest capital share and deputies are appointed from the other parties.

The management of the physical execution and the carrying out of the work is done by the site management team. The site management team consists of a general manager appointed by the Board of Directors and a group of department managers. The general manager receives his instructions from the board of directors and is responsible for the good general coordination and organization of the whole project with the direct assistance from the managers. To minimize conflict between the parties, the general manager and each of the department managers has its own deputies which come from the other parties.

**Integrated/Incorporated CJVs** For integrated/incorporated CJVs, they are managed by a Board of Directors. The venturers elect a set of officers from among themselves to compose the Board of Directors. Once in place, the Board independently manages the company, subject of course to the limitations set forth by the CJV Agreement.

Since it is a Thai regulation that majority of a company's capital must be owned by a Thai party, the chairmanship of the Board is

usually given to the Thai Party, although this is not compulsory. There is no fixed rule as to the distribution of directors from the partners, since they are elected. The Board of Directors is responsible for the overall conduct of the JV.

The management of the physical execution and the carrying out of the work is done by the site management team. The site management consists of a General Manager which is appointed by the Board of Directors and a group of Project Managers of Department Managers. The members of the site management team are from the key personnel of either party. The General Manager receives his instructions from the Board of Directors and is responsible for the good general coordination and organization of the whole project with direct assistance from the managers.

**Non-integrated/Unincorporated CJVs** Non-integrated/Unincorporated CJVs, on the other hand, have different approach. Instead of forming a Board of Directors, a Management Board is created. The Management Board is responsible for all matters concerning the combined activities of the parties and the overall direction and control of the works. The members of the Management Board are representatives of each venturers. Decisions of the Management Board are taken by unanimous resolution and are binding upon the parties. The chairman of the Management Board is usually from the sponsor party.

Like the integrated CJV (incorporated and unincorporated), the management of the physical execution and carrying out of the work in non-integrated/unincorporated construction JV is done by the Site Management Team. The Site Management team consists of a Project Director appointed by the Management Board from the sponsor and a group of Project-Managers from each venturer representing their-respective items of work. The Project Director received his instructions from the management board and is responsible for the good general coordination and organization of the whole project with the direct

assistance of the Project Managers. The site management team represents the JV with the employer and/or third parties.

### **Staffing**

Regarding the mixture of staff between foreign and Thai parties, there is no fixed rule as to how many are sourced from each party. The mix depends on the expertise requirement and from which party the personnel sought is available.

The Thai party, however, always appear to have the majority number, since the low-level personnel and clerical positions are always filled with Thais. The foreign party is usually composed of well-trained technical men, capable of importing technology from the parent firm. However, their number is usually limited partly due to the imposition of the work permit system<sup>4</sup> by the Thai government, but much more by the high cost of hiring foreigners in Thailand.

## **REASONS FOR FORMING CJVs**

### **Why Foreign Construction Companies Enter into JVs with Thai Firms**

First of all, it should be noted that here in Thailand, foreign construction companies are not allowed to engage in any local construction activities, except if the project is promoted by the BOI. Therefore, for the foreign construction companies to engage in construction activities in Thailand legally, they must seek partnerships with local firms to form a separate construction organization which could be called a Thai entity. An entity can be called a Thai entity only if majority of the capital (51%) is owned by Thais. Another reason is the political influence enjoyed by the foreign government over Thailand. Other reasons for foreign construction firms entering into JV with Thai companies are as follows:

1. To gain access to the country's construction industry.
2. Familiarity of local firms with local conditions are much better than the foreign companies.
3. Major companies maintaining or extending their expertise.

4. Greater control of supply sources through local with local contractors.
5. On construction projects financed by foreign loans, financiers often insist that the project must be contracted to a foreign-Thai JV

Thai partners are needed not only to legalize activities in Thailand but also to act as a link between them and the local construction environment.

### **Motivation for Local Construction Firms Entering into JVs with Foreign Companies**

In some specific areas of construction, Thai construction firms are still behind in terms of technology and expertise when compared to construction companies from developed countries. Hence, when faced with projects requiring international standards, or with projects requiring immediate realization, local firms sometimes find themselves deficient in advanced technology and expertise. With the desire therefore to expand and improve, they seek partnerships with foreign venturers for the following reasons:

1. To acquire sufficient knowledge in terms of manpower and know-how.
2. To diversify or gain experience at a relatively small risk.

It was originally thought that access to foreign capital might be a reason for joint venturing with foreign firms. None of the respondents agreed that foreign capital is necessary in winning contracts. However, it is understood that any contractor needs capital to set up a business.

### **PARTNER SELECTION**

For all the CJVs considered in this study, all the venturers found their partners through direct contact. This indicates that there are no local agencies supporting foreign construction venturers in finding suitable local partners, although it is an obvious fact that the said information is available from the Thai Contractors Association or sometimes from the project owners. This factor appears to be a problem to foreign venturers considering that they are unfamiliar with the local

construction industry. However, its effect is negligible. Considering the restrictions imposed by the Thai government on foreign equity participation (i.e., Thai must hold the majority of the capital) and considering also the management structure of a CJV (which normally involves several contractors of different background and policies), foreign venturers must seek out big local contractors or enterprises, to minimize the number of local partners thereby minimizing organizational or management problems. Such big contractors are not hard to find.

Two major factors need to be considered in selecting the prospective JV partner if an atmosphere of good and harmonious relationship is to be created. First, the initiating party must establish a goal first, why a CJV has to be formed. Secondly, the resources possessed must be assessed to know what resources are expected from the prospective JV partners. The joint venturers must have resources which complement each other and when combined must be sufficient enough to achieve the objectives of the JV. To create a good teamwork, the venturers must feel that they need each other.

The initiating party must see to it that the partner selected has the knowledge, expertise and money to see through the completion of the project. A partner must have something to contribute to the CJV so that good relationship may be developed and that suspicion and jealousy may be minimized.

All of the CJVs considered in this study think they have been successful in selecting the right partners. All of them are Thai-foreign CJVs-all foreign partners need a Thai party to enter the local construction industry while the local parties need the expertise and advanced technology possessed by the foreign party. This of course is only one of the factors which led to their success.

Another important factor which must be considered in selecting a right partner is market assurance-a certain situation of co-operation wherein the "by-product" of one of the parent companies can easily be passed

to the "hybrid" company. For example a foreign venturer, a foundation specialist in particular, seeks JV partnership with a Thai leading project developer to form a JV company which is also a foundation specialist. The foundation works of the Thai partner's parent company can easily be passed to the JV company, hence, this hybrid company is also assured to have projects, aside from the fact that it can also openly compete with other foundation specialists considering the technology and expertise it possessed.

## **PROCEDURE FOR ESTABLISHING A JV IN THAILAND.**

The formation of CJV in Thailand depends on the type of JV to be formed as follows:

Integrated/Unincorporated:

1. Finding firms for cooperation
2. Written proposal
3. Terms and conditions
4. Contract

Integrated/Incorporated:

1. Finding firms for cooperation
2. Feasibility study
3. Written proposal
4. Terms and conditions
5. Contract

Non-integrated/Unincorporated:

1. Finding firms for cooperation
2. Terms and conditions
3. Contract

Steps 2 and 3 for integrated/unincorporated and steps 2,3 and 4 for integrated/incorporated CJV can be executed interchangeably.

**Finding firms for cooperation:** For the three types of CJV discussed, the first step in forming them is finding firms for possible future cooperation. After having contacted each other, the local party and the foreign party may exchange their intents on a project of mutual interest. When some understanding is reached, then it could be said that a potential partner is found, therefore, future cooperation with the said firm is possible.

**Feasibility study:** When potential partners are found, the two parties concerned conduct

a feasibility study of the desired undertaking. The feasibility has to be made to determine if the investment climate of the country is favorable. In other words, feasibility study will attempt to give advance answer whether the company to be formed, being permanent in nature will survive. The feasibility report is then submitted to the Commercial Registration Department for approval. However, this stage is necessary only for integrated/incorporated form of CJV, being permanent in nature and requiring some government formalities.

**Submission of a written proposal:** While undertaking the previous steps, the venturers concerned may present their views and specifications concerning the matters of joint investment. When they reach an agreement on the major aspects, they then submit a written proposal for the JV project to the Commercial Registration Department. After the endorsement of the written proposal is done, the two parties may sign a letter of intent, after they have decided that sufficient interest exists on both sides to pursue the project. A letter of intent is not intended to be a legally binding document; it is merely a written declaration of intention by both parties to develop a particular project without specifying the exact details. For non-integrated form of CJV, the submission of a written proposal to the Commercial Registration Department is not necessary since the formation of the CJV of this form does not require any government formalities. However, they too sign a letter of intent

**Negotiation on terms and conditions:** Parallel also with the previous steps is the negotiation on terms and conditions for the JV agreement. A JV agreement is entered primarily to record the progress of the negotiation between parties and to stipulate the principal terms and conditions of their future cooperation. In establishing the CJV considered in the study being reported, the following terms and conditions were included.

1. **Organization:** the number and members of the Board of Directors and the organization structure of the

company.

2. Proportions capital in form of both cash and non-cash contributions, e.g., materials, plant, equipment, etc.
3. Scope of the business: the services to be provided by the JV.
4. Duration of the cooperation.
5. Accounting and Auditing: the accounting procedures to record the business in the financial and operation reports and to agree to the engagement of a registered public accountant to verify and audit the accounts.
6. Establishment of the office: the location of the office and the division of the work between the Thai and foreign partners in order to set up a firm.
7. Bank loans to be applied for from any bank in Thailand.

The terms and conditions have been arranged in order of importance. It can be seen that the most important factor to be included in the CJV agreement is the organization; the number and members of the board of directors and the organizational structure of the JV. This factor is considered as the brain of the company, hence, failure to give due consideration to this could mean a disaster to the JV. This is followed by the proportion of capital and scope of business. The least important factor appeared to be the bank loans, establishment of the office and accounting/auditing. However, since all the terms considered above can contribute something beneficial to the JV, it can also therefore cause problems if not considered thoroughly, hence, it is suggested that in forming a CJV, all of them must be considered (although not necessarily included) in detail.

Joint venture contract. After the feasibility study has been analyzed and considered acceptable and after all the other requirements as discussed are performed and satisfied, the parties then sign a JV contract incorporating all the principal terms and conditions of their future cooperation.

## Registration

All the CJVs considered in this study are registered in the Commercial Registration Department (CRD). Application form, agreement, contract and the list of the members of the management board or board of directors are required to be submitted to the CRD by all forms of CJVs considered in this study. However, for the feasibility study report and the written proposal, only integrated/incorporated form of CJVs are required to submit these things.

## MANAGEMENT AND FINANCE OF JVs

### Estimating and Bidding Procedure

The procedure for deriving estimates for purposes of submitting a bid is dependent on the type of CJV formed. For integrated (incorporated and unincorporated) CJVs, the procedure is the same as that practised by conventional construction companies since the JV in this form is acting as a single company in undertaking the project. However, for nonintegrated form of CJV, the procedure is quite different. Each partner prepares own estimate for his own share of job item. Each partner selects their own estimator to represent the party. To arrive at an estimate that is acceptable to every partner, an estimators' meeting is held prior to the bid submittal. The purpose of the meeting is to discuss the construction methods, final checking of the estimates and some other matters for the purpose of making a good estimate. The chairman of the estimators' meeting is the representative of the sponsor party. He moderates the opinions of other estimators to reach an agreement.

When a mutually agreed upon estimate has been made, it is then submitted to the respective heads of the participating companies. The respective heads of each partner then hold a meeting to set the mark-up.

### Capital

Thai Law regarding the control of foreign equity participation (i.e., Thai party must hold at least 51% of the capital) does not apply to the BOI-promoted projects. Also, for non-integrated/unincorporated CJV, there is no fixed sharing of equity participation the

parties. This is practical and Thai Law does not apply here because the work is divided among partners according to their expertise, hence, it is difficult and impractical to fix the capital sharing. Consequently, this form of CJV is applicable only to BOI-promoted projects, wherein capital sharing has no fixed limit.

### **Bank Transactions**

All the CJVs considered in the study opened bank accounts and can borrow money from both local and foreign banks. Local banks are necessary for local transactions, involving Thai Baht currency, while foreign bank accounts are needed for overseas transactions, such as purchases of equipment and materials from abroad.

### **Finance and Accounting**

For all the CJVs encountered in the study, management of financial affairs varied across ventures. Some hired a third party accounting firm while others created their accounting department to take charge of their money matters. This factor, however, has a direct effect on the formation and management of CJV. All the JVs studied use Thai Baht currency for book keeping purposes and all hired third party auditors.

### **Taxes and Contribution**

As per Thai Law, the standard rate of income tax on net profit is fixed at 35% for all types of CJV. No preferential rate is offered by the Thai government which means that CJV in Thailand do not enjoy any government privilege. However, the government does not impose any deductions from after-tax-profit for purposes of providing funds to the Thai construction industry. The treatment of net profit varies according to the type of CJV. For integrated/incorporated construction JV, the net profit is partly reinvested by the JV. This is practical for continuous form of CJV. However, for non-integrated construction JV (whether incorporated or non-incorporated), being project oriented, the net profit is distributed to the partners according to their percentage capital share.

### **Bonds**

The bonds usually required by owners from

CJVs are as follows:

1. Bid bonds
2. Performance bonds
3. Advance payment bonds
4. Retention bonds

It would seem that CJVs are not bonded beyond the normal requirements for a construction firm.

### **Construction Joint Venture Duration**

The duration of the CJV depends on the type of the JV being formed. For unincorporated CJV, regardless of whether it is integrated or non-integrated, being project oriented, the duration is fixed and depends on the duration of the project undertaken plus the maintenance period. However, for integrated/incorporated CJV, there is no fix duration, since this form of JV is continuous. As long as profitable environment exists, the entity also exists.

During the period of cooperation, all the CJVs considered in the study were not given the privilege to import equipment tax-free. This kind of privilege is not provided in Thailand.

Upon termination of the JV and after payment of taxes and discharge of liabilities, residual assets of the CJV are liquidated and distributed to the partners in accordance to their respective capital contributions.

After fulfilling all the responsibilities in respect to liabilities and taxes due to the Government of Thailand, the foreign partner of any CJV can remit foreign exchange abroad fully or partially depending on the guarantees they have to comply with. All such remittances are controlled by the Bank of Thailand.

### **SUMMARY**

CJVs in Thailand can exist in three forms: Integrated/Unincorporated; Integrated/Incorporated; and Non-integrated/Unincorporated. Whereas only the integrated/incorporated CJV is a separate legal entity from the venturers, all need to be registered by the Commercial Registration Department.

Although there are no fixed rules regarding the sourcing of personnel for the JV, most

Thai-Foreign CJVs are headed by Thai citizens originating from the Thai partner.

Thai-Foreign JVs must have at least 51% local participation if they are to be incorporated. Foreign companies enter into JVs with Thai firms mainly to comply with local regulations in gaining access to the local market or to meet bidding requirements of foreign aid projects. Local companies seek access to advanced technology and to minimise risk in gaining experience.

Much care is needed in partner selection if CJVs are to succeed in achieving their objectives. Foreign companies need to seek out local firms with good reputation and access to resources while Thai firms need to ensure that venture partners have the expertise they lack.

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